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CITY OF EL SEGUNDO
SINGLE AUDIT REPORT ON FEDERAL AWARDS
Year Ended September 30, 2009

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CITY OF EL SEGUNDO
SINGLE AUDIT REPORT ON FEDERAL AWARDS

Year Ended September 30, 2009

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Honorable Mayor and City Council
City of El Segundo, California

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

We have audited the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the City of El Segundo, California (City), as of and for the year ended September 30, 2009, which collectively comprise the City's basic financial statements and have issued our report thereon dated April 26, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily disclose all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control. We consider items 09-01, 09-02, and 09-

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03 as described in the accompanying Schedule of Findings and Questioned Costs to be significant deficiencies in internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all the deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. We did not identify any material weaknesses in internal control.

We noted certain other matters we reported to the management of the City in a separate letter dated April 26, 2010.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our testing disclosed one instance of noncompliance that is required to be reported under *Government Auditing Standards* and are described in the accompanying Schedule of Findings and Questioned Costs as item 09-04.

The City's written responses to the significant deficiencies identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the City's responses, and accordingly, we express no opinion on them.

This report is intended solely for the information and use of the City Council and management of the City and is not intended to be and should not be used by anyone other than these specified parties.

Mayor Hoffman McCann P.C.

Irvine, California
April 26, 2010



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**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO
EACH MAJOR PROGRAM, INTERNAL CONTROL OVER COMPLIANCE
AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
IN ACCORDANCE WITH OMB CIRCULAR A-133**

Compliance

We have audited the compliance of the City of El Segundo, California (City) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended September 30, 2009. The City's major federal program is identified in the Summary of Auditors' Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the City's compliance with those requirements.

In our opinion, the City complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended September 30, 2009. However, the results of our auditing procedures disclosed one instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying Schedule of Findings and Questioned Costs as item 09-04.

Honorable Mayor and City Council
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Internal Control Over Compliance

The management of the City is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the City's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over compliance. Accordingly we do not express an opinion on the effectiveness of the City's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the City's internal control that might be significant deficiencies or material weaknesses as described below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies.

A control deficiency in the City's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned function, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the City's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the City's internal control. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 09-01, 09-02, and 09-03 to be significant deficiencies.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in a more than remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the City's internal control. We did not consider any of the deficiencies described above to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended September 30, 2009, and have issued our report thereon dated April 26, 2010. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards, Schedule of Expenditures of Federal Awards for CDBG Projects, and Schedule of Expenditures of Federal Awards for LAWA Grants are

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presented for purposes of additional analysis as required by OMB Circular A-133 and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The City's written responses to the significant deficiencies identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the City's responses, and accordingly, we express no opinion on them.

This report is intended solely for the information of the City Council, management of the City of El Segundo and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Mayor Arthur M. ...

Irvine, California

April 26, 2010, except for the Schedule of Expenditures of Federal Awards, as to which the date is June 28, 2010

CITY OF EL SEGUNDO

Schedule of Expenditures of Federal Awards

Year Ended September 30, 2009

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Grantor's Number</u>	<u>Expenditures</u>
<u>U.S. Department of Transportation</u>			
Direct assistance:			
Federal Aviation Administration			
Airport Improvement Program			
Part 150 Noise Abatement	20.106*	AIP 3-06-0139-43	\$ 3,226,459
Part 150 Noise Abatement	20.106*	AIP 3-06-0139-47	<u>1,087,679</u>
Sub-total			4,314,138
Direct assistance:			
Federal Transit Administration	20.500	CA-03-0594	<u>357</u>
Total U.S. Department of Transportation			<u>4,314,495</u>
<u>U.S. Department of Housing and Urban Development</u>			
Passed through the County of Los Angeles			
Community Development Commission			
Community Development Block Grant	14.218	D96646-09	15,785
Community Development Block Grant	14.218	601209-09	<u>3,500</u>
Total U.S. Department of Housing and Urban Development			<u>19,285</u>
<u>U.S. Department of Homeland Security</u>			
Passed Through the State of California:			
Office of Emergency Services			
Urban Areas Security Initiative	97.008	C-112250	139,787
<u>U.S. Department of Treasury</u>			
Direct Program:			
Equitable Sharing Fund Program	21.000	CA0192300	592,164
<u>U.S. Department of Justice</u>			
Direct Program:			
Equitable Sharing Fund Program	16.000	CA0192300	<u>74,874</u>
Total Federal Expenditures			<u>\$ 5,140,605</u>

* Major Program

See Note to Schedule of Expenditures of Federal Awards

CITY OF EL SEGUNDO

Note to Schedule of Expenditures of Federal Awards

Year Ended September 30, 2009

(1) **Summary of significant accounting policies applicable to the schedule of expenditures of federal awards**

(a) **Scope of Presentation**

The accompanying schedule presents only the expenditures incurred by the City of El Segundo, California (City) that are reimbursable under programs of federal agencies providing financial awards. For the purposes of this schedule, financial awards include federal awards received directly from a federal agency, as well as federal funds received indirectly by the City from a non-federal agency or other organization. Only the portions of program expenditures reimbursable with such federal funds are reported in the accompanying schedule. Program expenditures in excess of the maximum reimbursement authorized or the portion of the program expenditures that were funded with other state, local or other non-federal funds are excluded from the accompanying schedule.

(b) **Basis of Accounting**

The expenditures included in the accompanying schedule were reported on the modified accrual basis of accounting. Under the modified accrual basis of accounting, expenditures are recognized when the city becomes obligated for payment as a result of the receipt of the related goods and services. Expenditures reported include any property or equipment acquisitions incurred under the federal program.

(c) **Subrecipients**

The City did not make any payments to subrecipients during the fiscal year ended September 30, 2009.

CITY OF EL SEGUNDO

Schedule of Findings and Questioned Costs

Year Ended September 30, 2009

(A) Summary of Auditors' Results

1. An unqualified opinion was issued by the auditors on the financial statements of the auditee.
2. The audit no material weakness in internal control over financial reporting.
3. The audit disclosed no instance of noncompliance which is material to the financial statements of the auditee.
4. There were no material weaknesses reported related to internal control over the major programs of the auditee.
5. An unqualified report was issued by the auditors on compliance for its major program.
6. The audit disclosed one finding required to be reported under paragraph .510(a) of OMB Circular A-133.
7. The major program of the auditee was CFDA No. 20.106, Department of Transportation, Federal Aviation Administration, Airport Improvement Program.
8. The dollar threshold used to distinguish Type A and Type B programs was \$300,000.
9. The auditee did not meet the criteria to be considered a low risk auditee, as defined by OMB Circular A-133, paragraph .530, for the year ended September 30, 2009 for purposes of major program determination.

(B) Findings Related to the Financial Statements which are Required to be Reported in Accordance with GAGAS

(09-01) Need to Establish a Formal Ethics Policy and Fraud Policy

We noted that the City already has in place a number of practices to communicate its expectation of ethical behavior to all employees through verbal communications, trainings and by setting proper tone at the top. However, we noted that the City does not have a formalized ethics policy. A well structured ethics policy establishes organizational standards for ethics, morals and an overall "regard for the rules" philosophical approach within the City. Specifically, matters such as honesty, integrity, compliance with laws and regulations, adherence to corporate policy and upholding the City's high values and reputation are addressed. A strong ethics policy is the foundation upon which the City builds its culture, which should then permeate all levels of personnel and guide all business dealings and transactions. This can be most effective in establishing a highly ethical and antifraud culture within any business organization.

CITY OF EL SEGUNDO

Schedule of Findings and Questioned Costs

(Continued)

(B) **Findings Related to the Financial Statements which are Required to be Reported in Accordance with GAGAS (Continued)**

We also noted that the City's practices do not include a clearly communicated process for employees to report suspected fraud or other unethical conduct. A written fraud policy can be an effective method of communicating and reinforcing an antifraud culture within a City. A fraud policy communicates the City's position and policy on matters to all employees such as the following:

- Risks that the City faces from fraud, abuse and other forms of misconduct;
- Definitions of ethical misconduct, including failure to follow City policies and procedures, misrepresentation of financial data, and theft, misuse, or misappropriation of City assets;
- Employee's responsibility to report witnessed ethical misconduct (including an established reporting mechanism, such as reporting to an independent party such as Human Resources, a member of the Board of Directors, a designated member of the City's management, hotline service, etc.);
- Organizational responsibility to investigate; and
- Disciplinary action for violations

Best practice suggests that an ethics policy and fraud policy and their annual reaffirmation by employees will greatly strengthen internal controls to prevent the occurrence of fraud and abuse. The policies should be acknowledged and signed by each employee upon hire and on an annual basis as evidence of their affirmation that they understand the policy and have complied with its provisions.

As of the date of this letter, the City's policy was drafted and pending approval by the City Council.

Recommendation

We recommend that the City establish and implement an ethics policy and a fraud policy. Once developed, the policies should be acknowledged and signed by each employee at time of hire and on an annual basis thereafter as evidence of their affirmation that they understand the policy and will/have complied with its provisions. We also suggest that the City implement an effective reporting mechanism for fraud and other unethical conduct. Internal reporting channels, such as managers' open-door policy, hotlines for anonymous tips or a clearly defined reporting protocol (what to report, who to report to, etc.), have been found to be effective. This is a repeat recommendation from the prior year audit.

CITY OF EL SEGUNDO

Schedule of Findings and Questioned Costs

(Continued)

(B) **Findings Related to the Financial Statements which are Required to be Reported in Accordance with GAGAS (Continued)**

Management's Response

The City is in the process formalizing an ethics and a fraud policy. Drafts of the policies have been written and are currently being reviewed by the City's attorney. Once they have been finalized, the policies will be presented to Council for approval.

(09-02) Golf Course Cash Disbursements

During our review and testing of internal controls over cash disbursements at the golf course, we noted the following:

- The Golf Course Accountant who processes accounts payable and prints the checks also receives the signed checks and mails them out.
- Although the Golf Course Accountant does give the check signers all supporting documentation with each check. However, the check signers do not receive the final check register for review to ensure all checks are being accounted for.

Recommendations

We recommend the following:

- The signed checks should not be returned to the Golf Course Accountant. Instead, someone independent of the accounts payable function (i.e. a receptionist or other staff member) should be responsible for stuffing, sealing, and mailing the checks.
- The check signers should be provided with the final check register along with the prior check register to ensure there are no gaps in check numbers and all checks are being reviewed and accounted for.
- The General Manager should receive the unopened bank statements to review the debits to the account as well as the fronts and backs of canceled checks to ensure payments were issued to authorized vendors.

Management's Response

The City and the management company have acknowledged the recommendations of MHM and have made changes to strengthen the internal controls of the Golf Course's cash disbursements process. The final check register for the current check run and the prior check

CITY OF EL SEGUNDO

Schedule of Findings and Questioned Costs

(Continued)

(B) **Findings Related to the Financial Statements which are Required to be Reported in Accordance with GAGAS (Continued)**

register are provided to the check signers to ensure all issued checks are present and reviewed. After the checks have been signed by the required two authorized signers, a designated pro shop attendant, who is independent of the accounts payable function, compares the checks to the supporting documentation to verify correctness of amount, payee and invoice number. The pro shop attendant stuffs, seals and mails the checks that are less than \$5,000 and/or are not payable to the management company. Checks greater than \$5,000 and/or payable to the management company are forwarded to the City's Finance Director for approval and the City Manager's signature. A designated person in the City's Treasury Department reviews the checks and supporting documentation for accuracy and proper signatures. Next, the Treasury Department personnel stuffs, seals and mails the checks.

Bank statements are mailed directly to the City's Treasury department, not the Golf Course. Each month, the Golf Course's accountant downloads a copy of the bank statement and prepares the bank reconciliation. A copy of the reconciliation and the bank statement is sent to the City Senior Accountant for review as a part of the month-end closing procedure

(09-03) Investment Compliance

Section 53601(k) of the *California Government Code* states the following:

"Medium term notes may not exceed 30 percent of the agency's money that may be invested. Notes eligible for investment under this subdivision shall be rated 'A' or better by a nationally recognized rating service."

As of September 30, 2009, medium-term notes represented 31.30% of the City's total investment portfolio. In addition, the ratings of three of the medium term notes were A3, BAA3, and WR as of year end. This condition occurred because the City Treasurer's office evaluates investment compliance at the time of purchase only.

Recommendation

We recommend the City Treasurer's Report include a statement to disclose any noncompliance issues as of the date of the City Treasurer's Report.

Management's Response

The Treasurer's office is aware that under the State Law we were out of compliance for our corporate holdings. With the fall of Lehman and the trouble with AIG, bonds that we bought

CITY OF EL SEGUNDO

Schedule of Findings and Questioned Costs

(Continued)

(B) **Findings Related to the Financial Statements which are Required to be Reported in Accordance with GAGAS (Continued)**

were in compliance with our investment policy at the time of purchase. It is the Treasury Department understanding that the 30 % rule applies at the time of investment, when we were in compliance. There is nothing our investment policy that requires the City to sell bonds at a loss to reach compliance.

(C) **Findings and Questioned Costs for Federal Awards as defined in Paragraph .510(a) of OMB Circular A-133**

(09-04) Financial Status Reports

FEDERAL AGENCY: Department of Transportation

CFDA NO.: 20.106

FEDERAL PROGRAM NAME: Airport Improvement Program

FEDERAL AWARD PROGRAM NO.: AIP 3-06-0139-43

AIP 3-06-0139-47

FEDERAL AWARD YEAR: 2006 and 2007

CONTROL CATEGORY: Reporting

QUESTIONED COSTS: \$0

The City did not submit a Financial Status Report during the fiscal year ended September 30, 2009. OMB Circular A-102, Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments ("Common Rule"), Subpart C, Section 40(b) requires that grantees submit Standard Form 269 or 269A to its granting agency on at least a quarterly basis. If the granting agency does not specify a frequency for the submittal of this report, then the report should be submitted annually (within 90 days after the end the fiscal year). This condition occurred because City staff was unaware of this reporting requirement. In addition, the City's contact at the Federal Aviation Administration (FAA) did not communicate the City's noncompliance with this requirement.

Recommendation

We recommend that the City submit a Financial Status Report (SF-269 or SF-269A) to the FAA per the frequency requested by the FAA (or at least annually). The report should reconcile to the City's general ledger. This is a repeat recommendation from last year's audit.

Management's Response

The City acknowledges the recommendations of MHM and will complete this form as required per the OMB Circular A-102 referenced.

CITY OF EL SEGUNDO

Summary Schedule of Prior Year Findings

Year Ended September 30, 2009

Finding Number 08-01

The water and sewer utility customer receivable balances were not adequately supported as of the balance sheet date. The City's water and sewer utility customer receivables have not been reconciled to the balance on the utility module in previous years. This lack of reconciliation resulted in the inability to determine accurate accounts receivable balances and has caused a significant variance between the ledger and utility billing module. In addition, revenues should be accrued at year end for unbilled water and sewer service charges,

Current Status

This issue has been resolved.

Finding Number 08-02

During the audit of the fiscal year ended September 30, 2008, numerous adjustments were identified by the audit process.

Current Status

This issue has been resolved.

Finding Number 08-03

The City does not have a formal ethics and fraud policy.

Current Status

See current year finding 09-01

Finding Number 08-04

Journal entries prepared by the Accounting Manager were not consistently reviewed before they were posted to the City's general ledger to ensure the entries were proper and adequately supported.

Current Status

This issue has been resolved.

CITY OF EL SEGUNDO

Summary Schedule of Prior Year Findings

(Continued)

Finding Number 08-05

The City's internal controls over the payroll area needed improvement in the following areas:

- Changes to the payroll system's master file (for adding/deleting employees and for pay rate changes) were not reviewed by a person independent of the payroll function.
- Personnel files being maintained for City employees were not complete.

Current Status

This issue has been resolved.

Finding Number 08-06

A person independent of utility billing process (and who does not have access to payments collected) should review the Accounting Technician's reconciliation between the lockbox account and payments posted in the City's utility billing software. In addition, a process needs to be implemented where voided transactions are reviewed and approved by the Accounting Technician's supervisor.

Current Status

This issue has been resolved.

Finding Number 08-07

The person processing cash disbursements for the City's Golf Course is also responsible for mailing the checks to the vendors. These duties should be performed by someone independent of the cash disbursements process.

Current Status

See current year finding 09-02.

Finding Number 08-08

The City did not submit an annual Financial Status Report (SF 269) for the fiscal year ended September 30, 2008 for its Airport Improvement Program.

CITY OF EL SEGUNDO

Summary Schedule of Prior Year Findings

(Continued)

Current Status

See current year finding 09-03

Finding Number 08-09

The City did not reduce total allowable expenditures for its Airport Improvement Program by program income earned through charges for services to residents when requesting reimbursement from the federal granting agency.

Current Status

This issue has been resolved.

CITY OF EL SEGUNDO

Schedule of Expenditures of Federal Awards for CDBG Projects

Year Ended September 30, 2009

CDBG Project	Project Number	Cash Receipts 2009	Prior Year Reversal	Current Year Accrual	Total Expenditures Per SEFA
Program Management	D96646-09	\$ 6,953	(4,680)	13,512	15,785
Installation of ADA Curb Cuts	601209-09	<u>125,859</u>	<u>(125,575)</u>	<u>3,216</u>	<u>3,500</u>
Totals		<u>\$ 132,812</u>	<u>\$ (130,255)</u>	<u>\$ 16,728</u>	<u>\$ 19,285</u>
Home Delivery Meals - Donation					18,189
Transfer from the General Fund					<u>165,208</u>
Total Expenditures					<u>\$ 202,682</u>

CITY OF EL SEGUNDO

**Schedule of Expenditures of Federal Awards
for LAWA Grant**

Year Ended September 30, 2009

	<u>Costs Claimed</u>	<u>Costs Accepted</u>	<u>Costs Questioned</u>	<u>Costs Recommended for Disallowance</u>	<u>City Matching</u>
Los Angeles World Airport (LAWA) Grant Fiscal Year 2008-09 Expenditures	\$ 4,467,205	\$4,467,205	\$ -	\$ -	\$ -
Totals	<u>\$ 4,467,205</u>	<u>\$4,467,205</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>